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TO: Members of the Subcommittee on Government Efficiency and Financial Management

and the Subcommittee on National Security, Emerging Threats and International

Relations

FROM: Chairman Todd Platts and Chairman Christopher Shays

DATE: July 1, 2004

SUBJECT: Oversight Hearing: "Business Process Modernization at the Department of

Defense" -- July 7, 2004, 2:00 p.m. 2247 Rayburn House Office Building

SUMMARY

Recent audits and investigations by GAO and DOD auditors continue to confirm the existence of pervasive weaknesses in DOD's financial management and related business processes and systems. The problems have (1) resulted in a lack of reliable information needed to make sound decisions and report on the status of day-to-day activities, including accountability of assets, and financial and other reports to Congress and DOD decision makers, (2) hindered operational efficiency, (3) adversely affected mission performance, and (4) left the Department vulnerable to fraud and waste. Although the senior Department of Defense leadership has repeatedly committed itself to transforming and improving the department's financial management and business process systems, limited progress has been made since Secretary Rumsfeld announced the effort in 2001.

This hearing will provide an update on the status of the BEA and the implementation of financial management and business process reforms (the Business Management Modernization Project) including reviewing suggestions for accelerating reforms and overcoming obstacles that hinder their implementation.

BACKGROUND

The Challenge

DOD is one of the largest and most complex organizations in the world and as a result, overhauling its business operations is a huge management challenge. In fiscal year 2003, DOD reported that its

operations involved over \$1 trillion in assets, nearly \$1.6 trillion in liabilities, approximately 3.3 million military and civilian personnel (1.4 million men and women on active duty, 1.2 million serving in Reserve and Guard components, and 675,000 civilians), and disbursements of over \$416 billion. DOD has a worldwide presence with approximately 474,000 military and civilian personnel deployed in more than 146 countries. DOD operates a massive infrastructure with more than 600,000 individual buildings located at more than 6,000 locations encompassing 30 million acres. The DOD's size, structure, and resources make it one of the largest enterprises in the world. DOD maintains about 250,000 vehicles, over 15,000 aircraft, more than 1,000 oceangoing vessels, and about 550 public utility systems.

The execution of its operations spans a wide range of defense organizations, including the military services and their respective major commands and functional activities, numerous large defense agencies and field activities, and various combat and joint operational commands that are responsible for military operations for specific geographic regions or theaters of operations. To execute these military operations, the department performs an assortment of interrelated and interdependent business process areas, including logistics management, procurement, healthcare management and financial management.

To fulfill its mission, DOD has developed over 2,300 separate financial management systems and possibly thousands of other feeder systems over the past four decades. This technology infrastructure is in large part aged and hampered by a lack of functional and technical integration. There is no question that the United States has the finest military force in the world, but the DOD's business and support structure is stuck in the middle of the 20th century.

Management Challenges – Underlying Causes

For a number of years the GAO has highlighted in many reports and testimonies the underlying causes of DOD's inability to resolve its long-standing financial management and related business management weaknesses and fundamentally reform its business operations. These underlying causes are:

- 1. A lack of sustained top-level leadership in management accountability for correcting problems;
- 2. Deeply embedded cultural resistance to change, including military service parochialism and stovepiped operations;
- 3. A lack of results oriented goals and performance measures and monitoring; and
- 4. Inadequate incentives and accountability mechanisms relating to business transformation efforts.

Failure to address these underlying causes will likely result in the failure of current DOD initiatives according to the GAO.

Additionally, DOD's structure and reporting relationships are a constraint on its ability to develop an enterprise architecture and reform its business and financial management systems. DOD has not routinely assigned accountability for performance in its business transformation effort to specific organizations and individuals who have sufficient authority to accomplish desired goals. As an example, the Comptroller who is by statute the department's CFO, has direct responsibility for only estimated 20 percent of the data relied on to carry out the department's financial management operations. The other 80 percent comes from DOD's other business operations and is under the control and

authority of other DOD officials. Another challenge is that many DOD components continue to receive funding from multiple appropriations and continue to make their own parochial investment decisions. While the domains, as part of the BEA, have been designated to oversee business systems investments to ensure that they are consistent with the goals and objectives of the business enterprise architecture, their specific roles and responsibilities have not been clearly defined and most importantly, they do not have control over budgets.

The Case for Business Process Modernization

Since the early 1990s with the passage of the Government Performance and Results Act, the Chief Financial Officers Act, and the Federal Financial Management Improvement Act, DOD has come under increasing pressure to receive a clean audit opinion and, therefore, allow a clean audit opinion for the U.S. government as a whole. DOD has been the subject of hundreds of studies and analyses over the past two decades. Since 1995 the General Accounting Office (GAO) alone has conducted hundreds of reviews and analyses on DOD's financial management, information management, high-risk areas and major management challenges. Private sector organizations have also conducted studies and made recommendations on improving the DOD structure. In February 2001, Business Executives for National Security (BENS) published the "Call to Action," which included a matrix of recommendations from previous studies going back to the 1986 Packard Commission. In addition, shortly after Secretary of Defense Rumsfeld took office, he requested that the Institute for Defense Analyses conduct a study to recommend a strategy for financial management improvements within the Department.

Although these analyses differ in focus and area of concentration, they have a common thread in their recommendations -- the urgent need for fundamental structural reform in DOD's financial management and business processes. GAO has consistently found that existing systems cannot provide reliable financial data to support informed decision-making and promote accountability, thereby leaving DOD at high risk of fraud, waste and mismanagement. The BENS analysis recommended that "there be no more studies—just do it." BENS estimated that the reforms highlighted in their study would bring world-class business practices to DOD, and result in savings conservatively estimated at \$15 to \$30 billion per year. The commission expressed concern that only three out of 10 Pentagon dollars go to fund weapons systems, training and combat capabilities; and 70 percent of the defense budget is spent on support functions.

The Institute for Defense Analyses (IDA) Study Group, comprised of experienced business people, supported by a private sector professional services firm under separate contract, was tasked by Secretary Rumsfeld to develop the framework for effective transformation of financial management throughout the DOD. The study group recommended that the DOD:

- 1. Build a department-wide architecture and transition plan that uses standard business and financial rules:
- 2. Employ a department-wide oversight process, led by senior leadership, to implement the architecture and to monitor departmental spending;
- 3. Refine and extend the architecture to create a seamless connection between it and other federal and DOD transformation initiatives; and
- 4. Complete the development and implementation of the governance oversight process.

Following this group's recommendations, in September 2001, Secretary Rumsfeld announced a broad high-priority initiative intended to "transform the way the department works and what it works on." The DOD transformation is comprised of two endeavors, a business process and financial management effort transforming antiquated bureaucratic methods and computer systems into best practices, state of the art integrated automated systems, and a Force transformation, aimed at transforming military doctrine, concepts, structures and systems to achieve force-wide network centric capabilities (command and control).

The new broad-based business transformation initiative incorporates a number of defense reform initiatives begun under previous administrations and encompasses additional fundamental business reform proposals. Secretary Rumsfeld recognized the transformation would be difficult and would take years to complete. The Secretary's initiative is consistent with the findings of the IDA independent study, which concluded DOD would have to undergo "a radical financial management transformation" and that it would take more than a decade to achieve.

BEA and BMMP - The Solution?

As part of this effort the Secretary established the Business Management Modernization Program (BMMP) to direct and oversee financial management reform within the department. A new directorate within the Office of the Under Secretary of Defense (Comptroller) was created to lead the reform effort. Its main task is to develop a Business Enterprise Architecture (BEA), a blueprint that will coordinate business processes and integrate financial management systems department-wide and establish effective management and control over its business modernization investments. In April 2002, DOD awarded a major contract for development of this new enterprise architecture. The team is led by IBM and main subcontractors KPMG, Science Applications International Corporation, Computer Sciences Corporation, and American Management Systems, with small-business contractors Infolnx, Alliance International Corporation, Popkins, Spherion and Vertex Information and Computer Consulting Services. In total approximately 250 professionals from these organizations are working on the program.

To ease the transformation to the new financial management enterprise architecture, Secretary Rumsfeld created two advisory panels to oversee implementation. The Senior Executive Council is guiding the effort within the department, and the Defense Business Practice Implementation Board, a committee of seasoned business executives, is advising the Secretary based on best practices in the private sector.

BMMP is a Herculean effort to change the way DOD handles its business processes, including eliminating redundant and non-compatible systems. In addition, BMMP seeks to streamline, reengineer, and standardize the Department's business processes. The FY05 funding request for BMMP is \$122 million, not including various financial management pilot programs, which represent another \$66 million. Thus, the FY05 BMMP and BMMP-related program requests are \$188 million. This is in addition to the \$257.8 million the Department has already received from FY2002-2004.

The Congress has been strongly supportive of DOD's efforts to transform its business operations and systems through the use of an enterprise architecture. In addition to addressing its human capital problems by granting DOD human capital flexibility resulting in the department developing a new personnel management system for its civilian employees, Congress included provisions in the FY2003 National Defense Authorization Act that were aimed at developing and effectively implementing a well-

defined architecture. Specifically, section 1004 of this Act required that DOD develop, by May 1, 2003, a financial management enterprise architecture and a transition plan for implementing the architecture that meets certain requirements and review financial system improvements with proposed obligation of funds in amounts exceeding \$1 million to determine if those system improvements meet specific conditions that are called for in the Act. The Act also directed GAO to assess the actions DOD takes to comply with these requirements. In July and September 2003, GAO reported on the these actions and made a number of recommendations to assist DOD in its efforts to effectively develop and implement an architecture and guide and constrain its business systems investments.

The Act further requires that the Secretary of Defense submit an annual report not later than March 15 of each year in 2004 through 2007 to Congressional defense committees on its progress in implementing the architecture, including the transition plan. The Act also directs GAO to submit to Congressional defense committees within sixty days of DOD's report submission an assessment of DOD's actions taken to comply with these requirements.

The Implementation Effort

On May 17, 2004, GAO provided the Congress its congressional mandated assessment of DOD's progress report in implementing the Business Enterprise Architecture, including the transition plan. GAO concluded:

- 1. Since the last review -- and after three years and over \$203 million in obligations, there has been little significant change in the content of DOD's architecture or its approach to investing billions of dollars annually in existing and new systems. Few actions have been taken to address the recommendations GAO made in a September 2003 report, which were aimed at improving DOD's plans for developing the next version of the architecture and implementing institutional means for selecting and controlling both planned and ongoing business systems investments.
- 2. DOD has not yet adopted key management best practices and has not added the scope and detail to its architecture that GAO previously identified as missing.
- 3. DOD has not implemented an effective management structure and processes to provide adequate control and accountability over its \$5 billion annual investment in business systems modernization.
- 4. The Department does not have reasonable assurance that it is in compliance with the National Defense Authorization Act for fiscal 2003, which requires DOD's comptroller to review all system improvements with obligations exceeding \$1 million. Based on limited information provided by DOD, systems improvements with at least \$863 million of obligations over \$1 million were not reviewed by the DOD comptroller.

In a Report to the House Government Reform Subcommittees on Government Efficiency and Financial Management; Technology, Information Policy, Intergovernmental Relations and the Census; and National Security, Emerging Threats, and International Relations, which is being released at this hearing, the GAO concludes that billions continue to be invested with inadequate management oversight and accountability. The GAO conducted two case studies on logistics systems modernization efforts -- the Defense Logistics Agency's (DLA) Business Systems Modernization Program (BSM), and the Army's Logistics Modernization Program (LMP) to determine if they will help resolve some of the

department's long-standing financial and inventory management problems. The result of its two case studies led the GAO to conclude that while the efforts will provide some improvements to DLA's and the Army's business operations, implementation problems have resulted in schedule delays, cost increases, and critical capabilities not being delivered. In brief, DOD is spending hundreds of millions on business systems that will not result in corporate solutions to its long-standing inventory and related financial management problems.

Although DOD requested approximately \$19 billion for fiscal year 2004 to operate, maintain, and modernize more than 2300 business systems, many of those business systems remain fundamentally flawed. The overall evidence of improvements in DOD business operations is limited to specific business process areas, such as DOD's purchase card program, or improvements generally resulting from increased management focus and better internal control rather than from major modifications to automated systems.

High Risk Areas and Operational Consequences

As part of its legislatively mandated responsibilities, including preparing the annual Consolidated Financial Statement of the U. S. Government and its annual FFMIA report, the GAO maintains a list of high risk program areas throughout government agencies. Six DOD program areas are on GAO's high-risk list and the Department shares responsibility for three of the government-wide high-risk areas. These nine interrelated high-risk areas are: contract management, financial management, human capital management, information security, support infrastructure management, inventory management, real property, systems modernization and weapons acquisition.

The impact of these high-risk areas on the operations of the Department were recently summarized by GAO as follows:

Business Area	Problem Identified
Affected	
Military Pay	Ninety-four percent of mobilized Army National Guard soldiers GAO investigated had pay problems. These problems distracted soldiers from their missions, imposed financial hardships on their families, and had a negative impact on retention.
Logistics	Asset visibility and other logistical support problems hampered mission readiness during Operation Iraqi Freedom, including cannibalization of vehicles for parts and duplication of requisitions.
Travel	Seventy-two percent of the over 68,000 premium class airline tickets DOD purchased for fiscal years 2001 and 2002 were not properly authorized and 73 percent were not properly justified.
Property	New JSLIST chembio suits sold on the internet for \$3 while at the same time DOD was buying them for over \$200. Further, thousands of defective suits, declared excess by DOD, were improperly issued to local law enforcement agencies-which are likely to be first responders in case of a terrorist attack.
Contract Payments	Some DOD contractors were abusing the federal tax system, with little or no consequence. As of September 2003, DOD had collected only \$687,000 of unpaid federal taxes through a mandated levy program. GAO estimated that at least \$100 million could be collected annually through effective implementation of the levy on DOD contract payments.

What is most disturbing about the impact of these serious problems and weaknesses in DOD's business processes and financial management systems is not only the billions in wasted resources, but even more important is the increasingly severe adverse impact of these weaknesses on DOD's operational

capabilities. DOD's reliance on software-intensive systems to support operations involving intelligence, surveillance, security, and sophisticated weaponry in addition to financial management and other business functions will only increase as the Department modernizes and responds to warfighting concepts and techniques.

ISSUES TO BE ADDRESSED

- What is the status of the BMMP?
- What are the goals of the BMMP and are those goals being met?
- o How are commercial best practices being incorporated in the BMMP?
- o How can the reforms be accelerated and what obstacles stand in the way of a successful project?
- o Is the Comptroller effectively implementing the language of the FY 2003 DOD Authorization requiring approval of IT investments in excess of \$1 million?

WITNESSES

Mr. Lawrence Lanzilotta, Under Secretary of Defense, Comptroller (Acting)

Mr. Greg Kutz, Director of Financial Management and Assurance, General Accounting Office

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